DIPP ISSUES REGULATIONS ON FOREIGN INVESTMENT IN E-COMMERCE; LIBERALIZES INSURANCE AND PENSION SECTORS

Introduction

The Indian government has implemented a host of reforms to liberalize India's foreign direct investment ("**FDI**") regime. Last week, the Indian government issued guidelines clarifying the FDI policy in the e-commerce sector, and has also further liberalized FDI in the insurance and pension sectors.

This update discusses these recent changes announced by the Indian government.

Foreign investment in the e-commerce sector

Previously, 100% FDI was permitted in Business-to-Business ("**B2B**") e-commerce without the prior approval of the Foreign Investment Promotion Board (the "**FIPB**"), and entities operating in this area had to adhere to the guidelines on cash and carry or wholesale trading specified under the FDI policy. Further, a single brand retail trader having foreign investment and operating through brick and mortar stores in India could undertake single brand retail trading through e-commerce. However, Business-to-Customer ("**B2C**") e-commerce was not permitted.

The Department of Industrial Policy and Promotion (the "**DIPP**") has issued press note no. 3 (2016 series) (the "**Press Note**") clarifying that foreign investment in B2C e-commerce marketplaces will be permitted, subject to certain conditions. The "[m]arketplace based model of e-commerce" has been defined to mean the provision by an e-commerce entity of an information technology platform on a digital or electronic network (which can include a network of computers, television channels or any other internet applications used in an automated manner) to act as a facilitator between the buyer and the seller. The conditions in the Press Note in respect of FDI in B2C e-commerce marketplaces are as follows:

- the marketplace entity can enter into transactions only with sellers registered on its platform on a B2B basis;
- the marketplace entity must not own the goods sold on its platform;
- the name, address and other contact details of the seller must be specified on the marketplace entity's platform;
- the delivery of goods to the customers, any warranty or guarantee of the products, after sales support, and customer satisfaction must be the responsibility of the seller;
- the marketplace entity must not permit more than 25% of its sales to be effected through its platform from one (1) seller or its group companies;
- the marketplace entity must not, directly or indirectly, influence the sale price of the goods sold on its platform and must maintain a level playing field; and

- the marketplace entity can provide to sellers support services such as warehousing, logistics, order fulfillment, call centers and payment collection.

The Press Note clarifies that FDI will not be permitted in the "[i]nventory based model of e-commerce," which has been defined to mean e-commerce activity where the inventory of goods and services is owned by the e-commerce entity and is sold to consumers directly.

Lastly, the Press Note clarifies that foreign investment in entities engaged in the sale of services through e-commerce will be permitted.

What happens to the existing players!

India is one of the fastest growing e-commerce markets in the world, and is expected to be worth US$38 billion this year. As more Indians go online, they are increasingly looking to shop at the click of a button with a wider range of products available on various portals and more often than not at highly discounted prices.

FDI in India's e-commerce sector until date is estimated to be as high as US$5 billion. Global e-commerce majors like Amazon have pumped in billions of dollars and have announced big plans for the Indian market. Further, foreign private equity and sovereign wealth funds have also shown a keen interest in this sector notwithstanding the regulatory restrictions.

From a business standpoint, the inventory model is considered more profitable, and also aids small manufacturers as the inventory risk is passed on to the e-retailer and their products are made available on a much larger and easily accessible platform. Statistics also suggest that the e-commerce market has helped the logistics industry grow significantly in India.

Therefore, in our view, the Indian government should have taken a step to liberalize foreign investment in the inventory model of e-commerce instead of imposing restrictive conditions on the marketplace model.

Over the past few years, Indian brick and mortar retailers have raised concerns on the business models adopted by e-commerce entities like Amazon, Flipkart and others, who have operated as B2B marketplaces with FDI although, they may have, technically, owned the customer. In fact, a petition was filed by the All India Footwear Manufacturers & Retailers Association in the Delhi High Court last August on this issue. It appears that the conditions in the Press Note may be a fallout of the Delhi High Court's push that the government should clarify the policy.

With onerous conditions including, (i) the inability to influence the price of the products sold (meaning no deep discounts); and (ii) the inability to permit more than 25% of sales to be effected through its platform from one (1) seller or their group companies (meaning restrictions on back-end wholesale entities who aggregate products from sellers), it is expected that many e-commerce entities will have to restructure their operations to comply with the Press Note. However, the government has not given a timeframe for existing companies to undertake such a restructuring exercise. Further, by imposing sanctions on discounts, customers stand to lose. All in all, the conditions in the Press Note may create difficulties for some of the existing e-commerce companies in India, and it does not appear that the last word has been written on this subject.

Foreign investment in the insurance and pension sector

After years of debate on the implications of foreign investment in the insurance sector, the Indian Parliament passed the Insurance Laws (Amendment) Act, 2015 in March 2015, which increased the FDI limit in the insurance sector from 26% to 49% with prior approval of the FIPB for investments exceeding 26%. Similarly, the FDI limit in the pension sector was increased from 26% to 49% with prior approval of the FIPB for investments exceeding 26%. The limit of 49% is an aggregate cap for all types of foreign investment, including FDI and foreign portfolio investments.

Earlier this year, the Finance Minister announced that foreign investment in the insurance and pension sectors above 26% would not require FIPB approval. Accordingly, the DIPP has now issued press notes to permit foreign investment in the insurance and pension sectors up to 49% without FIPB approval. All other conditions specified in the FDI policy in respect of foreign investment in the insurance and pension sector continue to apply as is.